Answers

1 REP Ltd

Notes for meeting

Client	REP Ltd and Lamar
Purpose	Discussion of corporate and personal matters
Prepared by	Tax senior
Date	8 September 2020

(a) Knowledge obtained from advising other clients

– We have experience of advising clients trading from permanent establishments situated overseas.

We have also advised on trading in the country of Garia.

– We will be able to use this general experience and expertise for the benefit of REP Ltd.

– However, we must not use any confidential information obtained as a result of our professional and business relationships for the benefit of REP Ltd (or any other client).

Confidentiality is one of the fundamental principles of ethics within ACCA's Code of Ethics and Conduct.

– This principle of confidentiality applies to confidential information obtained in respect of both ex-clients and continuing clients.

Tutorial note: *candidates who mentioned the fundamental principle of professional competence and due care were also awarded credit.*

(b) Investment in JAY Ltd

(i) Residency of JAY Ltd

Taxation of profits

The profits of the business will be generated in Garia regardless of where JAY Ltd is resident.

Accordingly, the profits will always be subject to business tax at 13% in Garia.

If JAY Ltd is resident in the UK

The profits would be subject to UK corporation tax because the permanent establishment (PE) in Garia is not a separate legal entity and UK resident companies are subject to corporation tax on their worldwide profits.

However, double tax relief would be available in the UK: the amount payable in the UK would be 6% (19% – 13%) of the profits, as set out below:

	£
UK corporation tax (£135,000 x 19%)	25,650
Less: Unilateral double tax relief (£135,000 x 13%)	(17,550)
UK corporation tax payable	8,100

If JAY Ltd is resident in Garia

The profits will only be subject to tax in Garia at the rate of 13%, as noted above.

JAY Ltd would not have a UK corporation tax liability in respect of these profits.

Any dividends received by REP Ltd and CRO Ltd from JAY Ltd would be exempt from corporation tax.

Relief available in respect of trading loss

If JAY Ltd is resident in the UK

If REP Ltd owns 30% of JAY Ltd:

– JAY Ltd would be a consortium company because at least 75% of JAY Ltd would be owned by companies, each of which own at least 5%, and less than 75%, of the company.

– In these circumstances, REP Ltd would be able to offset up to 30% of JAY Ltd's trading loss against its taxable total profits.

If REP Ltd owns 20% of JAY Ltd:

– No relief would be available to REP Ltd in respect of any trading loss of JAY Ltd because CRO Ltd would own more than 75% of JAY Ltd.

If JAY Ltd is resident in Garia

No relief would be available in the UK for REP Ltd in respect of any trading losses realised by JAY Ltd in Garia.

(ii) Election to exempt the profits of JAY Ltd's overseas PE from UK tax

This election is available to UK resident companies which generate profits from PEs situated overseas. If JAY Ltd were to make this election:

- its profits in Garia would no longer be subject to corporation tax in the UK. If no election is made, UK corporation tax would be payable on the profits in Garia at the rate of 6% (19% – 13%) after double tax relief;
- no relief would be available in the UK in respect of any losses generated by the activities in Garia;
- it would be irrevocable;
- it would apply to all future overseas PEs of JAY Ltd.

(iii) Controlled foreign company (CFC) rules

The UK tax system charges corporation tax on the worldwide profits of UK resident companies. However, it does not charge corporation tax on the profits earned overseas by a non-UK resident company.

A UK resident company could seek to exploit the latter rule by establishing a non-UK resident subsidiary in which to generate its overseas profits. The CFC legislation is designed to prevent overseas subsidiaries being used to avoid tax in this way.

Where the rules apply (and no exemption is available), UK resident companies owning at least 25% of a CFC are charged UK corporation tax on their proportionate share of the CFC's chargeable profits.

(c) Purchase of investment property

When REP Ltd grants a lease of the building to a tenant, it will be making an exempt supply.

REP Ltd will not be able to recover any value added tax (VAT) in relation to the purchase of the building unless it makes an election opting to tax it.

Opting to tax the building would have the following additional implications:

- REP Ltd would be required to charge VAT on the monthly rental payments due from the tenant.

  This will not be a problem where the tenant is able to recover all of the VAT charged. However, any irrecoverable VAT will represent an additional cost to a potential tenant.
- Apart from an initial cooling-off period of six months, an option to tax a building cannot be withdrawn until 20 years have elapsed.
- Whilst the option to tax remains in place, REP Ltd would be required to charge VAT on a sale of the building.

(d) Proposed gift of shares to trust on 1 November 2020

Inheritance tax (IHT) payable

	£	£
Transfer of value (W)		900,000
Annual exemptions for 2020/21 and 2019/20		
(used by PET on 1 July 2020)		–
Chargeable amount		900,000
Nil rate band		325,000
Less: chargeable transfer in the previous seven years		
1 May 2016	170,000	
Annual exemptions:		
2016/17	(3,000)	
2015/16 (used by PET on 1 February 2016)	–	
		(167,000)
		158,000
Taxable amount (£900,000 – £158,000)		742,000
IHT payable (£742,000 x 25%)		185,500

Working

Transfer of value

	£
Value of shares held prior to the gift: (80,000 x £24 (80%))	1,920,000
Value of shares held after the gift: (60,000 x £17 (60%))	(1,020,000)
Transfer of value	900,000

2 Freya

(a) Sale of business

Capital gains tax (CGT) payable if Freya remains in the UK and sells business assets

If Freya remains in the UK, and sells her business assets rather than incorporating, her CGT liability would be £85,000 (£850,000 x 10%).

The rate of CGT would be 10% due to the availability of entrepreneurs' relief. This relief would be available because Freya would have disposed of the whole of her business which she will have owned for more than two years.

Sale of business to FIM Ltd in exchange for shares

It has already been determined that the conditions for incorporation relief will be satisfied. Incorporation relief will defer all of the chargeable gains arising on the sale of the assets of the business, such that no CGT would arise. Instead, the gains will be deducted from Freya's base cost in the shares, giving a revised base cost of £1,450,000 (£2,300,000 – £850,000).

Freya's residence status whilst living in Benida

Freya will not satisfy any of the automatic residency tests. Accordingly, it is necessary to consider the number of ties which she will have with the UK and the number of days she wishes to spend in the UK.

The ties to be considered in respect of a tax year are:

	Satisfied?
– Spouse or children under 18 who are UK resident	No
– Accommodation available in the UK for a continuous period of more than 90 days which was stayed in for at least one night during the tax year	Yes
– Working in the UK for 40 days or more	No
– In the UK for more than 90 days in either or both of the previous two tax years	
2021/22 and 2022/23	Yes
2023/24 onwards	No
– Spend more time in the UK than in any other country	No

Freya will satisfy two ties in the tax years 2021/22 and 2022/23 and only one tie in subsequent years. Therefore, she can spend up to 90 days in the UK in each of the first two tax years and up to 120 days in each of the subsequent years without becoming UK resident.

In conclusion, if Freya were to live in Benida in accordance with her ideal scenario (returning to the UK for 25 working days and 30 additional days in each tax year) she will be non-UK resident in all years.

Sale of shares in FIM Ltd without incurring a UK CGT liability

In order for there to be no UK CGT on the gain on the sale of the shares in FIM Ltd, Freya would need to be:

- not resident in the UK in the tax year of sale; and
- not a temporary non-UK resident.

It has already been determined that Freya will not be UK resident while she is living in Benida.

The temporary non-resident rules prevent individuals avoiding UK CGT by realising chargeable gains whilst they are outside the UK for relatively short periods.

The rules will apply:

- to Freya because she will have been UK resident for at least four of the seven tax years immediately prior to the year of departure; and
- to the shares in FIM Ltd because they will be owned by Freya on the day she leaves the UK.

In order not to be caught by these rules, Freya will need to remain non-UK resident for a minimum period of five complete years rather than the three years in her ideal scenario.

If she returned to the UK after no more than three years, the chargeable gain realised on the sale of the shares would be subject to CGT in the tax year in which she returned.

(b) Liability to income tax and class 4 national insurance contributions (NIC): tax year 2020/21

	£
Trading profit for the final 17-month period	94,000
Add: balancing charge on sale of car (W)	1,560
Less: overlap profits	(31,400)
Taxable trading profit	64,160
Less: personal allowance	(12,500)
Taxable income	51,660
£37,500 x 20%	7,500
£14,160 (£51,660 – £37,500) x 40%	5,664
Income tax liability	13,164
£41,368 (£50,000 – £8,632) x 9%	3,723
£14,160 (£64,160 – £50,000) x 2%	283
Class 4 NIC liability	4,006

Working

Capital allowances

	Main pool	Private use car	Allowances
	£	£	£
Tax written down value (TWDV) brought forward	0	8,700	
Additions	4,200	–	
	4,200	8,700	
Disposals:			
Plant and machinery at TWDV (succession)	(4,200)		
Private use car at market value		(11,100)	
	0	(2,400)	
Balancing charge	–	2,400	
		x 65%	(1,560)

(c) Land in Benida

The gift of the land could not result in a UK inheritance tax (IHT) liability if it were made whilst Alvaro is domiciled in Benida. This is because overseas assets owned by non-UK domiciled individuals are not subject to UK IHT.

However, Alvaro will become deemed domiciled in the UK on 6 April 2021 because he will then have been UK resident for the 15 tax years prior to the year of transfer.

Accordingly, in order to ensure that no UK IHT liability can arise, Alvaro should give the land to Freya prior to 6 April 2021.

3 Amelia

(a) (i) Reliefs available in respect of Amelia's trading loss of the year ending 31 December 2020

The loss of the year ending 31 December 2020 is a loss of the tax year 2020/21. Accordingly, Amelia can offset the loss against her total income of 2020/21 and/or 2019/20. If she chooses to offset the loss against her total income of 2020/21, she can then offset any remaining loss against her chargeable gains of that year.

(ii) Relief against income and chargeable gains in the tax year 2020/21

In the tax year 2020/21, Amelia's only income will be savings income of £6,000. This will be covered by her personal allowance, such that she will have no liability to income tax for this year. Accordingly, if she chooses to take relief for the loss against this income, there will be no income tax saving. However, the remaining loss of £8,000 (£14,000 – £6,000) could then be offset against her chargeable gains for the year.

Amelia's chargeable gains comprise total gains less the capital loss brought forward i.e. £62,000 (£45,000 + £28,000 – £11,000). Accordingly, the full £8,000 of trading loss could be offset.

Ignoring offset of the trading loss, Amelia would have taxable gains of £50,000 after deducting the annual exempt amount of £12,000. As Amelia will have no taxable income in 2020/21, £37,500 of her taxable gains will fall within her basic rate band, and the remaining £12,500 will be taxed at the higher rate.

The trading loss should therefore be offset against the gain on the UK rental property, as this will be taxed at the higher, residential property rates of 18%/28% (working). The capital gains tax (CGT) saving will be £2,240 (£8,000 x 28%).

Working

Offset of remaining trading loss against chargeable gains

	Residential property gain £	Other gain £	Total gains £
Gain on UK rental property	45,000		45,000
Gain on Swartz Ltd shares		28,000	28,000
Less: Trading loss converted to capital loss	(8,000)		(8,000)
Less: annual exempt amount	(12,000)		(12,000)
Less: capital loss brought forward	(11,000)		(11,000)
Taxable gains after loss relief	14,000	28,000	42,000

Tutorial notes:

1. *After taking relief for the trading loss, only £4,500 (£42,000 – £37,500) of Amelia's taxable gains will be taxed at the higher rate, instead of £12,500.*
2. *The trading loss would be treated as a current year capital loss in the CGT computation, (i.e. it would be deducted from Amelia's chargeable gains before deducting the annual exempt amount and the capital loss brought forward), as shown above. However, candidates were awarded full credit regardless of the order in which they deducted the trading loss.*

Relief against income in the tax year 2019/20

In the tax year 2019/20 Amelia's total income is £47,600 (£30,000 + £11,600 + £6,000), so the full amount of the loss of £14,000 can be offset. Amelia's taxable income was £35,100 (£47,600 – £12,500), such that she was a basic rate taxpayer. The loss offset (which is against her non-savings income of this year) would generate a tax saving of £2,800 (£14,000 x 20%).

Relief against income in the tax years 2020/21 then 2019/20

Amelia could offset the loss against her income of £6,000 in 2020/21, with the remaining £8,000 offset against her income in 2019/20. This would save no tax in 2020/21, and only £1,600 (£8,000 x 20%) in 2019/20.

(b) Capital gains tax and income tax implications of the sale of Warehouse 1 and the acquisition of Warehouse 2 and the forklift truck

The sale of Warehouse 1 will give rise to a chargeable gain of £32,000 (£118,000 – £86,000).

Rollover relief will be available to defer part of this gain because Amelia acquired a qualifying replacement asset, Warehouse 2, during the year prior to the sale.

The acquisition of the forklift truck does not qualify for rollover relief as it is a moveable asset.

The gain which is eligible for rollover relief is restricted to £24,000 (£32,000 x ¾) because Amelia only occupied three of the four floors of Warehouse 1 for business purposes.

The rollover relief available will be further restricted because not all of the proceeds relating to the business use of Warehouse 1 have been used to acquire Warehouse 2:

	£
Proceeds of business element (£118,000 x ¾)	88,500
Cost of replacement	(83,000)
Gain remaining chargeable	5,500

The balance of the eligible gain of £18,500 (£24,000 – £5,500) will be available for rollover relief. Amelia's chargeable gain in respect of the sale of Warehouse 1 will therefore be £13,500 (£32,000 – £18,500).

The gain of £18,500 will be rolled over and deducted from the base cost of Warehouse 2. The base cost of Warehouse 2 will be £64,500 (£83,000 – £18,500).

The cost of the forklift truck of £23,000 will be eligible for the annual investment allowance in AS Trading's year ending 31 December 2021.

(c) Deregistration for value added tax (VAT)

Amelia is able to apply to voluntarily deregister for VAT on 31 December 2020 as the value of her taxable supplies in the following year are not expected to exceed the deregistration limit of £83,000. Her registration will be cancelled from 31 December 2020, or from a later date agreed with HM Revenue and Customs (HMRC).

On deregistration, output VAT will be payable on all non-current assets and inventory held by Amelia, on which input VAT was previously reclaimed. If the total VAT payable does not exceed £1,000, no payment is needed.

As a result of deregistration, Amelia will not be able to reclaim input VAT on the acquisition of Warehouse 2 and the forklift truck.

4 Dorian

(a) Reason for close company status

A company is a close company if it is controlled by:
- Any number of shareholders who are also directors, or
- The five largest shareholders in the company.

Control is exercised by shareholders who own more than half of the company's issued share capital.

For the purpose of determining control, a shareholder is regarded as owning any shares owned by their associates, in addition to the shares which they own personally. Associates include direct relatives, so Dorian is associated with his father.

Dorian is regarded as owning 28% of the shares (his own 5% plus his father's 23%). The remaining five directors own a total of 25%, so that overall the six directors own 53% of the issued share capital, and control the company.

Tutorial note: *There are additional complexities when determining whether or not a company is a close company, but the above points were sufficient to score full marks.*

(b) Tax implications for Dorian and Taupe Ltd of early repayment of Dorian's £7,500 loan

There will be no tax implications for Dorian. This will be the only loan outstanding in 2022/23, so there will be no loan interest benefit arising as it does not exceed £10,000.

As Taupe Ltd is a close company, it will have paid notional tax of £2,438 (£7,500 x 32.5%) to HM Revenue and Customs (HMRC) in respect of the loan to Dorian, who is a participator in the company.

HMRC will repay the £2,438 to Taupe Ltd nine months and one day after the end of the accounting period in which the loan is repaid.

Accordingly, if Dorian repays the loan on 30 April 2022, Taupe Ltd will receive the repayment by 1 February 2023, one year earlier than it would if the loan were repaid on 30 June 2022.

Tutorial note: *Notional tax will have been payable in respect of the £7,500 loan made to Dorian as Dorian (including his associate (Basil)) has a material interest (>5%) in Taupe Ltd.*

(c) The cost to Dorian of the two alternative travel assistance proposals

Alternative 1: Provision of an interest-free loan to purchase a season ticket

Dorian already has an existing interest-free loan from Taupe Ltd of £7,500. If he receives a further loan from Taupe Ltd of £4,800, the total amount outstanding will exceed £10,000, such that a taxable benefit will arise in respect of the whole of these loans.

Both of the loans are interest-free, so there will be a taxable benefit, calculated by reference to the official rate of interest, of £308 ((£7,500 + £4,800) x 2·5%). This will be subject to income tax at 40%, as Dorian will be a higher rate taxpayer in 2021/22, but the loans will not result in a liability to Class 1 national insurance contributions (NIC) for Dorian. The income tax payable would be £123 (£308 x 40%).

When the loan is written off on 5 April 2022, the amount written off will be treated as a distribution, and therefore liable to income tax at the rate of 32·5%. As Dorian has no other dividend income, the dividend nil rate band would be available, such that Dorian would incur an income tax liability of £910 ((£4,800 – £2,000) x 32·5%)).

The cost to Dorian of this alternative will be £1,033 (£123 + £910).

Alternative 2: Payment of a mileage allowance and provision of a free car-parking space

The mileage allowance will be subject to income tax at 40% and Class 1 NIC at 2%. This will give rise to a total tax cost of £1,512 (£3,600 x 42%).

Dorian will have additional travel costs, not covered by the mileage allowance of £300 ((£5,220 – £1,320) – £3,600).

Provision of a car parking space at, or near, an employee's normal place of work is an exempt benefit for income tax and NIC.

The total cost to Dorian of this alternative is therefore £1,812 (£1,512 + £300).

Provision of the interest-free loan to purchase a season ticket results in the lower overall cost for Dorian.

Tutorial notes.
1. *Although Dorian is an employee of Taupe Ltd, the loan written off is still treated as a distribution, rather than employment income. However, the amount written off will be liable to Class 1 NIC and candidates who were aware of this were awarded credit.*
2. *The approved mileage rates are not relevant in this case as the driving costs are not related to journeys made in the course of Dorian carrying out his duties of employment.*

(d) Implications for Taupe Ltd of the late filing of its corporation tax return

Taupe Ltd's corporation tax return for the year ended 30 April 2019 should have been filed by 30 April 2020 (12 months after the end of the period of account), as the notice requiring the filing of this return was issued before 1 February 2020.

As the return was filed more than three months late, a fixed late filing penalty of £200 will arise. Although the return for the year ended 30 April 2018 was also filed late, the penalty will not be increased to £1,000 as the return for the year ended 30 April 2017 was filed on time.

				Available	*Maximum*
1	**(a)**	One mark for each relevant point		5	
				5	5
	(b)	**(i)**	Taxation of profits		
			Subject to tax in Garia	1	
			JAY Ltd is UK resident	3	
			JAY Ltd is resident in Garia	2	
			Relief for losses		
			JAY Ltd is UK resident	4	
			JAY Ltd is resident in Garia	1	
				11	9
		(ii)	One mark for each relevant point	4	
				4	3
		(iii)	One mark for each relevant point	4	
				4	3
	(c)	Granting of lease		2	
		Implications for the tenant		2	
		Implications for the future		2	
				6	5
	(d)	Taxable amount of transfer to trust		2·5	
		Nil rate band		2·5	
		Inheritance tax liability		1	
				6	6
		Organisation of content		1	
		Clarity of explanations and calculations		1	
		Effectiveness of communication		1	
		Overall presentation and style		1	
				4	4
	Total				**35**
2	**(a)**	Sale of unincorporated business		2	
		Sale of business to FIM Ltd		2	
		Residency			
			Consideration of ties	5	
			Consideration of days and conclusion	2·5	
		Sale of shares in FIM Ltd		4	
				15·5	13
	(b)	Capital allowances		3·5	
		Other aspects of taxable income		2·5	
		Income tax and class 4 NIC liability		2	
				8	8
	(c)	No IHT whilst non-UK domiciled		1·5	
		Consideration of deemed domicile		2·5	
				4	4
	Total				**25**

				Available	Maximum
3	**(a)**	**(i)**	Reliefs available	3·5	3
		(ii)	Relief in 2020/21 – against income	1·5	
			– against gains	5	
			Relief in 2019/20	2·5	
			Relief in 2020/21 and 2019/20	1	
				10	8
	(b)		Availability of rollover relief	2·5	
			Calculation of rollover relief	3·5	
			AIA on fork-lift truck	1	
				7	6
	(c)		Deregistration for VAT	4	
				4	3
	Total				**20**

			Available	Maximum
4	**(a)**	General definition	2	
		Associates	1	
		Application to scenario	1·5	
			4·5	4
	(b)	Tax implications for Dorian	1	
		Tax implications for Taupe Ltd	4	
			5	5
	(c)	Interest benefit	3·5	
		Loan written off	2	
		Mileage allowance alternative	4	
			9·5	8
	(d)	Filing date	1·5	
		Penalty	2	
			3·5	3
	Total			**20**